

UT 07-4

Tax Type: Use Tax

**Issue: Use Tax On Aircraft Purchase
Rolling Stock (Purchase/Sale Claimed To Be Exempt)**

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE,
Taxpayer**

**No. 00-ST-0000
IBT# 0000-0000
NTL# 00 00000000000000**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Shepard Smith on behalf of the Illinois Department of Revenue; John ABC Hoff, Esq. and Jeffrey Clement, Esq. on behalf of John Doe.

Synopsis:

The Department of Revenue (hereinafter "Department") issued a Notice of Tax Liability ("NTL") to the taxpayer, John Doe, M.D. on February 15, 2006 for use tax due on the purchase of an aircraft. The taxpayer protested this NTL contending that the aircraft purchased was exempt because the aircraft constituted rolling stock for use in interstate commerce exempted from tax pursuant to 35 ILCS 105/3-55. A hearing on this matter was held on January 30, 2007 at which John Doe testified. Subsequent to the hearing the parties have submitted memoranda of law detailing their respective positions

in this matter. (The submission of these memoranda of law was delayed due to the unavailability of the transcript of the hearing proceedings until March, 2007). Following a review of the record in this case, including all testimony, stipulations and documentary evidence presented during the hearing, and the post hearing memoranda submitted by both parties, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the SC-10-K Audit Correction and/or Determination of Tax Due, and Notice of Tax Liability number 00 00000000000000 issued to the Taxpayer on February 15, 2006 showing a total liability due and owing in the amount of \$102,195 for state Use Tax delinquencies, penalty and interest. Dept. Ex. 1.
2. The SC-10-K Audit Correction and/or Determination of Tax Due and the aforementioned Notice of Tax Liability was determined by the Department's auditor based upon the taxpayer's failure to submit to the Department any evidence that the aircraft at issue was used in interstate commerce at any time subsequent to its arrival in Illinois on November 9, 2003. Dept. Ex. 2.
3. Dr. John Doe, M.D. (hereinafter "Doe" or "Taxpayer") purchased a 000000000000000000 aircraft (hereinafter the "Aircraft") from Anywhere Jet Center in Anywhere, Alabama on January 30, 2002. Anywhere Jet Center is an aircraft retailer. Department of Revenue ("Dept.") Exhibit ("Ex.") 2.
4. Doe paid no sales or use tax on the Aircraft to the State of Alabama or any other state at the time the Aircraft was purchased. Dept. Ex. 2.

5. ABC Aviation Inc. (hereinafter “ABC Aviation”), an Illinois domiciled corporation having its principal place of business in Anywhere, Illinois, is an Interstate Commerce Carrier for hire, a Federal Aviation Administration (“FAA”) certified Part 135 Air Carrier in possession of an FAA issued “Air Carrier Certificate”, and is authorized by the FAA to operate a charter aircraft service pursuant to 14 C.F.R. 135. Tr. pp. 13, 18, 20, 21, 23; Taxpayer’s Ex. B, C, H. ABC Aviation is also engaged in the business of performing maintenance and repair work on aircraft. Tr. p. 33; Taxpayer’s Ex. D, G.
6. On February 18, 2005, Doe entered into a Lease Agreement with ABC Aviation (hereinafter “Lease Agreement”) to lease the Aircraft to ABC Aviation for a period of one year commencing January 1, 2005 and ending January 1, 2006. Pursuant to the terms of this Lease Agreement, the Aircraft is to be used in ABC Aviation’s business as an FAA certified Air Carrier consisting of the provision of interstate on-demand and air charter services. Taxpayer’s Ex. F.
7. The Aircraft was transported to ABC Aviation’s facilities located at the Anywhere County Airport in Anywhere County, Illinois on November 9, 2003. Tr. pp. 13, 30, 32; Dept. Ex. 2.
8. The Taxpayer registered the Aircraft with the Illinois Department of Transportation on January 22, 2003, showing as his residential address an address in Chicago, Illinois. Dept. Ex. 2.
9. In order for the Aircraft to be used for the purposes indicated in the Lease Agreement it is required to meet “Carrier Operational Specifications” enumerated by the FAA. In order to meet these requirements, the Aircraft must be test flown and certified as

“Airworthy” pursuant to Part 43 of the Federal Aviation Regulations (14 C.F.R. 1.1 *et seq.*). Taxpayer’s Ex. C.

10. Subsequent to its arrival in Illinois on November 9, 2003, the Aircraft has never been flown due to on-going repairs needed in order to be certified as “Airworthy” by the FAA, and has not been used by ABC Aviation or any other interstate carrier to transport passengers or cargo on any flights either within Illinois or between points in Illinois and locations outside of this state. Tr. pp. 13 – 15; Taxpayer’s Ex. C.
11. In an attempt to meet FAA standards and requirements for certification, the Aircraft has undergone extensive repairs, modifications and refurbishments while at ABC Aviation’s facilities in Illinois. The cost of these repairs has exceeded \$170,000. Taxpayer’s Ex. G.
12. Doe is not a pilot, and has never made any personal use of the Aircraft subsequent to its arrival in Illinois. Tr. pp. 29, 30, 35.

Conclusions of Law:

The Department contends that the taxpayer, John Doe (“Doe” or the “Taxpayer”), engaged in a taxable use of the Aircraft at issue in Illinois commencing on November 9, 2003. Department Ex. 1, 2. The record in this case shows that the Aircraft at issue was sold to the Taxpayer by an Alabama aircraft dealer and brought into Illinois on that date. *Id.* The Taxpayer owned the Aircraft at the time of delivery to Illinois and registered the Aircraft in his name as owner, showing as his residential address an address in Illinois.¹

¹ Doe does not contend, and has offered no evidence to establish, that he was a resident of another state at the time the Aircraft at issue was brought into Illinois, and has not attempted to rely upon the “non-

Id. The record indicates that he arranged for the aircraft at issue to be stored, serviced and repaired. Tr. pp. 30-36; Taxpayer's Ex. B, D, E, G. These acts are clear indicia of ownership and the exercise of control over tangible personal property incident thereto constituting the taxable use of such property in this state. Sundstrand Corp. v. Department of Revenue, 34 Ill. App. 3d 694 (2nd Dist. 1975).

The Use Tax Act (35 **ILCS** 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 **ILCS** 105/3. Section 12 of the Use Tax Act incorporates by reference section 4 of the Retailers' Occupation Tax Act (35 **ILCS** 120/1 *et seq.*), which provides that the corrected return issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due, as shown therein. 35 **ILCS** 105/12; 35 **ILCS** 120/4. The Department established its *prima facie* case in this matter by submitting the corrected return into evidence. Id. The burden thus shifted to the Taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987). To prove its case, the Taxpayer was required to present more than its testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). The Taxpayer had to present sufficient documentary evidence to support its claim for an exemption. Id.

Doe contends that the aircraft at issue is exempt pursuant to section 3-55(b) of the Use Tax Act, 35 **ILCS** 105/3-55(b), the so-called "rolling stock" exemption. Tr. p. 13; Taxpayer's Memorandum of Law pp. 1, 4-11. It is well settled that tax exemption

resident" exemption contained at 35 **ILCS** 105/3-70 as a defense to the Department's assertion of tax liability.

provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). The party claiming an exemption has the burden of clearly proving that it is entitled to exemption, and all doubts are to be resolved in favor of taxation. *Id.*

The “rolling stock” exemption under the Use Tax Act provides in relevant part as follows:

§ 3-55. Multistate exemption. The tax imposed by this Act does not apply to the use of tangible personal property in this State under the following circumstances: ...

- (b) The use, in this State, of tangible personal property by an interstate carrier for hire as rolling stock moving in interstate commerce or by lessors under a lease of one year or longer executed or in effect at the time of purchase of tangible personal property by interstate carriers for-hire for use as rolling stock moving in interstate commerce as long as so used by interstate carriers for-hire ... [.]

35 ILCS 105/3-55(b)²

As indicated by the foregoing, if the taxpayer is a lessor, in order to qualify for the “rolling stock” exemption the taxpayer must establish that: (1) the aircraft or other vehicle is under lease of one year or longer to a certified interstate carrier; (2) the lease was signed or in effect at the time the aircraft or other vehicle was purchased by the lessor; (3) the aircraft or other vehicle was used by an interstate carrier for hire; and (4) the aircraft or other vehicle moved in interstate commerce. In order to prove that the vehicle moved in interstate commerce, the taxpayer must show that its interstate use of the vehicle was regular and frequent or more than merely incidental (see National School Bus Service, Inc. v. Department of Revenue, 302 Ill. App. 3d 820 (1st Dist. 1998), and that the aircraft or other vehicle was actually used in interstate commerce during the

² The “rolling stock” exemption is applicable to aircraft. See 86 Ill. Admin. Code, ch. I, § 130.340(b).

period covered by the assessment (Midland Railroad v. Department of Revenue, 66 Ill. App. 3d 397 (1st Dist. 1978)).

Doe, the taxpayer herein, purchased a 0000 000000 000000000000 aircraft (hereinafter the “Aircraft”) from Anywhere Jet Center located in Anywhere, Alabama on January 30, 2002. Dept. Ex. 2; Taxpayer’s Ex. B. Doe paid no tax to the State of Alabama on this aircraft at the time it was purchased. Dept. Ex. 2. At the time this aircraft was brought into Illinois, no use tax was paid on this aircraft. *Id.* Subsequent to the delivery of the Aircraft to Illinois, the Illinois Department of Revenue issued Notice of Tax Liability number 00 00000000000000 assessing use tax upon this aircraft in accordance with section 35 **ILCS** 120/4 incorporated by reference into the Use Tax Act (35 **ILCS** 105/1 *et seq.*) by 35 **ILCS** 105/12. The Taxpayer contested this assessment claiming that the Aircraft is for use as rolling stock and therefore, exempt from the application of the Illinois use tax. The Department denied the Taxpayer’s contention, resulting in the Taxpayer’s protest and hearing request.

The Department contends that the Aircraft does not qualify for the “rolling stock” exemption because: (1) the lease of the Aircraft to an interstate carrier for hire was not executed until after the date the Aircraft was purchased (see summary of facts in this case at Department’s Brief p. 1); and (2) the Aircraft was never flown subsequent to its delivery in Illinois and therefore did not move in interstate commerce subsequent to the assessment date indicated in the Department’s Notice of Tax Liability (see Department’s Brief pp. 2-5).

As noted above, in order to qualify for the “rolling stock” exemption as a lessor, the lessee must be considered an interstate carrier for hire. 35 **ILCS** 105/3-55. The

record in this case indicates that ABC Aviation, the lessee, is an interstate carrier for hire. Specifically, the record indicates that the lessee possesses an Air Carrier Certificate issued on September 22, 1989 and reissued on August 14, 2000. Taxpayer's Ex. H. Accordingly, the record shows that the statutory requirement that the lessee be an interstate carrier is satisfied in this case. See 86 Ill. Admin. Code, ch. I, section 130.340(f).

While the aforementioned prerequisite to claiming the "rolling stock" exemption has been met by the Taxpayer, there are serious problems with the Taxpayer's claim to this exemption. The record indicates that the Taxpayer is a lessor of tangible personal property, and is not, himself, a certified interstate carrier. Pursuant to the Lease Agreement the lessee, ABC Aviation, is to pay the lessor, Doe, \$1300 per flight hour for the use of the Aircraft. Taxpayer's Ex. F. Given this fact, the first reason indicated by the record as a basis for the Department's denial of the rolling stock exemption in this case is the Taxpayer's failure to satisfy the statutory requirement applicable to lessors that the lease to a lessee engaged in interstate commerce be "executed or in effect at the time of purchase of tangible personal property claimed as rolling stock." 35 ILCS 105/3-55; 86 Ill. Admin. Code, ch. I, section 150.310(a)(2). The record plainly shows that the Lease Agreement between the Taxpayer and ABC Aviation was entered into on February 18, 2005, while the Aircraft at issue was purchased on January 30, 2002. See Dept. Ex. 2; Taxpayer's Ex. F.

While there is evidence of intent to enter into a lease agreement with ABC Aviation or some other certified interstate carrier at the time the Aircraft was purchased (Tr. p. 21), the intent to enter such an arrangement cannot be considered the equivalent of

an executed lease, as contemplated by the statute. It is clear from the evidence elicited at the hearing that the purchase of the Aircraft took place prior to the execution of the Lease Agreement between the Taxpayer and ABC Aviation. Therefore, the statutory prerequisite that the lease to a certified interstate carrier be in effect or at least executed at the time of the purchase of tangible personal property intended for lease, was not satisfied in this case. On this basis alone, the Taxpayer has failed to rebut the Department's *prima facie* case of tax liability.

Even if one were to accept the evidence contained in the record that the Taxpayer intended to lease the Aircraft to the lessee as satisfying the aforementioned statutory requirements, the Taxpayer's attempt to rely upon the "rolling stock" exemption to exclude the Aircraft from taxation would still fail because the Taxpayer has also failed to show that the Aircraft has ever actually moved in interstate commerce. The Illinois courts have consistently, and without exception, held that evidence of regular and frequent movement of goods or people in interstate commerce must be shown in order to qualify for the "rolling stock" exemption granted by section 3-55 of the Use Tax Act. National School Bus Service, Inc., supra; Midland Railroad, supra; First National Leasing & Financial Corp. v. Zagel, 80 Ill. App. 3d 358 (4th Dist. 1980); Burlington Northern, Inc. v. Department of Revenue, 32 Ill. App. 3d 166 (1st Dist. 1975). Specifically, the Taxpayer must show that: 1) the Aircraft moved in interstate commerce during the period under audit³ (Midland Railway, supra), and 2) that the interstate use of the Aircraft was regular and frequent or more than merely incidental (National School

³ The period audited for use tax compliance commenced on November 9, 2003 when the Aircraft at issue in this case arrived in Illinois and concluded no later than February 16, 2006, the date of the Notice of Tax Liability issued to the Taxpayer. Dept. Ex. 1, 2.

Bus, supra).⁴ The Taxpayer presented no evidence to prove that either of these prerequisites has been satisfied. To the contrary, the Taxpayer concedes that the Aircraft has never been moved anywhere at any time since its arrival in Illinois. Because the Taxpayer has presented no evidence that the Aircraft was ever used for interstate transport after its use in Illinois commenced, it has failed to satisfy the requirements of section 3-55 of the Use Tax Act, 35 **ILCS** 105/3-55 that a vehicle actually move in interstate commerce, and that such movement be “regular and frequent.” Consequently, I find that the Taxpayer has failed to rebut the *prima facie* correctness of the Department’s determination that the “rolling stock” exemption does not exempt the Taxpayer’s Aircraft from use tax in this case.

In support of his claim that the “rolling stock” exemption is applicable in this case, the Taxpayer has produced voluminous evidence that the Taxpayer intends to use the Aircraft in controversy pursuant to the terms of the Lease Agreement with ABC Aviation upon the completion of repairs required to comply with FAA standards and the receipt of a certificate of “Airworthiness” from the FAA. Taxpayer’s Ex. B, C, D, E, G; Taxpayer’s Memorandum of Law pp. 6-10. In order for the Taxpayer to prevail, I must accept the evidence that has been submitted expressing the intent to use the Aircraft in the manner contemplated by the Lease Agreement with ABC Aviation as the equivalent of actual use of the Aircraft in a manner that satisfies the statutory prerequisites. However, it is patently obvious that an actual use contemplated by the statute as

⁴ The Department’s regulations also require actual movement of aircraft or other vehicles in interstate commerce. See 86 Ill. Admin. Code, ch. I, section 130.340(d) (“[E]xcept as provided in subsection (g) of this Section, the exemption applies to vehicles used by an interstate carrier for hire ... [.]” Emphasis added).

construed in Midland Railway, *supra*, National School Bus, *supra*, National Leasing and Financial Corp., *supra* and Burlington Northern, *supra* cannot be equated with an intended use of the property since all of these cases require proof of some significant level of actual interstate movement.

The court's holding in Midland Railroad, *supra*, is particularly pertinent to the Taxpayer's claim. In Midland, the court rejected a taxpayer's claim that the Department improperly limited the plain meaning of the "rolling stock" exemption "by considering only the movement of cars during the audit period." Midland, *supra* at 399. In addressing this argument, the court states: "[T]he auditor did not alter the plain meaning of the statute by restricting his attention to the audit period ... [S]ome period had to be chosen in order to administer the Act. ... [I]ndeed, in Burlington Northern the court, in applying the exemption, considered only those movements of rolling stock during the audit period utilized in that case." *Id.* As in Midland, the Taxpayer in the instant case also contends that his use of tangible personal property in interstate commerce at some future date, a date that is clearly outside of the period audited by the Department, should be used to evaluate the Taxpayer's eligibility for exemption. However, use of evidence concerning a period other than the period under audit in evaluating a taxpayer's eligibility for the "rolling stock" exemption is contrary to the court's holding in Midland Railroad and therefore must be rejected here.

Moreover, according to an intended use the status of actual use does not comport with the stated intent of the "rolling stock" exemption. The intent behind the "rolling stock" exemption is the avoidance of multistate taxation. See 86 Ill. Admin. Code, ch. I, section 150.310(a) ("To prevent actual or likely multi-state taxation, the tax shall not

apply to the use of tangible property in this State under the following circumstances: ... (2) the use, in this State, of tangible personal property by an interstate carrier for hire as rolling stock ... [.]”⁵ The case of Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) allows a state to impose a tax on interstate commerce only under certain qualifying conditions that limit the possibility of multiple state taxation of a single activity. As the aforementioned administrative regulation indicates, in enacting section 3-55 of the Use Tax Act (35 **ILCS** 105/3-55), the Illinois legislature, being cognizant of these constitutional constraints, was reiterating that in order to prevent actual or likely multistate taxation, certain situations are exempted from the application of use tax.

There is no suggestion that the facts elicited in this case indicate that any other state was in a position to impose its use tax on the Aircraft after the issuance of the Notice of Tax Liability to the Taxpayer. This is true because there was absolutely no utilization of the Aircraft in any other state after it was brought into Illinois. See Findings of Fact #10. Given this fact, it is inconceivable that another state could constitutionally impose a tax on the Aircraft. (As noted previously, no tax was imposed upon the Aircraft in controversy by the state where the Aircraft was purchased, Alabama, or by any other state).

The Taxpayer further contends that failing to grant exemption places the Taxpayer at risk of multi-state taxation once it qualifies the Aircraft as Rolling Stock. This argument is cogently rebutted by the Department in its brief, wherein it states the following:

⁵ The statement of intent contained in the preamble to 86 Ill. Admin. Code, ch. I, section 150.310(a) noted above tracks verbatim the language contained in the preamble to 35 **ILCS** 105/3-55 when this section was originally enacted. See National School Bus, *supra* at 822; Midland, *supra* at 398-99.

Department does not agree with the Taxpayer's argument set forth on Pg. 9 of its Memorandum of Law which opines "Therefore, denying Dr. John Doe the exemption puts him at risk of being subjected to multistate taxation once the aircraft is added to ABC Aviation's Part 135 "Air Charter" service Certificate, thereby frustrating the purpose of the "Rolling Stock Exemption". The events that taxpayer advances as being the reasons why multiple taxation would be violated have not occurred and are therefore speculative. This is why the test is actual usage. One cannot tell what the future holds. ... [T]he aircraft might never be used in interstate commerce. On the contrary, the real danger is that the Taxpayer will escape use taxation altogether as the record is devoid of any evidence that any use tax has been paid on the aircraft in question. The law abhors such a result.
Department's Brief p. 4.

As noted previously, when granting exemptions from tax, the burden is on the taxpayer to prove clearly and conclusively its entitlement thereto. Statutes which exempt property or entities from taxation must be strictly construed in favor of taxation and against exemption. Heller v. Fergus Ford, *supra*. In the case at bar, the Taxpayer has failed to carry this burden of proof. Moreover, for the reasons herein enumerated, the Taxpayer has failed to present sufficient evidence to rebut the presumed correctness of the Department's *prima facie* case. It is, therefore, my determination that the Taxpayer is not entitled to the rolling stock exemption, and that the Use Tax at issue was properly assessed upon the Taxpayer's Aircraft.

RECOMMENDATION

It is my recommendation that Notice of Tax Liability number 00 00000000000000 be affirmed in its entirety.

Ted Sherrod
Administrative Law Judge

Date: July 13, 2007